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Dept. Of Commerce & Insurance  
Company Examinations

**Report on Examination  
of  
American General Property Insurance Company**

**Nashville, TN**

**as of**

**December 31, 2001**

**Department of Commerce and Insurance**

**State of Tennessee**

**Nashville**

EXHIBIT

tabbles

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STATE OF TENNESSEE  
DEPARTMENT OF COMMERCE AND INSURANCE  
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January 9, 2004

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Commissioners:

Pursuant to your instructions and in accordance with Tennessee Insurance Laws and Regulations, and Resolutions adopted by the National Association of Insurance Commissioners (NAIC), a financial examination and market conduct review was made of the condition and affairs of :

## **AMERICAN GENERAL PROPERTY INSURANCE COMPANY**

American General Center  
Nashville, Tennessee 37250

(hereinafter referred to as the Company) as of December 31, 2001, and a report thereon is hereby respectfully submitted.

### **Scope of Examination**

The Company was last examined as of December 31, 1996, by the Tennessee Department of Commerce and Insurance and representatives of the Northeastern, Western and Southeastern (intra-zone) NAIC zones of the NAIC. The only recommendation included in the previous report on examination was that the Company should report its parent company as the source of federal income tax recoverable. Procedures for this examination included a review of the Company's reporting of federal income tax recoverable for compliance with Statutory Accounting Principles and Tennessee Statutes.

This examination, which began April 1, 2002, covers the intervening period from January 1, 1997 through December 31, 2001, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination. This exam was conducted by representatives of the Tennessee Department of Commerce and Insurance and an examiner from the State of Delaware representing the Northeastern NAIC zone.

The examination consisted of a review of corporate minutes and records, verification and valuation of assets and determination of liabilities, reserves and the resulting unassigned (surplus) funds of the Company in accordance with the rules and regulations established by the National Association of Insurance Commissioners (NAIC) and as prescribed or permitted by Tenn. Code Ann. Article 56 and Related Laws, Rules and Regulations. Financial Condition Examination Procedures were adhered to as promulgated by the NAIC.

An examination was also made into the following matters:

Company History  
Management and Control  
Corporate Records  
Holding Company System  
Fidelity Bond and Other Insurance  
Employee Welfare  
Territory, Plan of Operation and Direct Premiums by State  
Growth of the Company  
Loss Experience  
Statutory Deposits  
Market Conduct Activities  
Reinsurance  
Accounts and Records  
Financial Statement

Such tests and reviews were conducted as were deemed necessary or appropriate for the purposes of this examination. This report is written by exception, except for certain items of regulatory significance, and those matters examined and found to be substantially in compliance with statutes will not be commented on further. Events subsequent to the December 31, 2001 examination date are included where relevant and appropriate.

The Company is audited annually as part of the audit conducted for the holding company system by an independent accounting firm. The audit for the year ended 2001 was completed during this examination and the auditors' workpapers were made available to the examiners in June 2002. While the independent auditors' workpapers were made available in a very timely fashion, the work documented therein did not include enough substantive testing to preclude the examiners' detail testing. Workpapers that were useful included documentation of the Company's procedures and verification of internal controls. These were relied upon where sufficient for the purposes of this examination and copies are included in the examination files where appropriate.

The annual statements for the years ended December 31, 1997 through 2001 were reviewed and reconciled to the Company's books of account.

## Company History

The Company was incorporated as NPO Insurance Company (NPO), a Tennessee company, on September 24, 1974. NPO was wholly-owned by NLT Corporation (NLT). Another wholly-owned subsidiary of NLT, Service Casualty Company of New York was incorporated under the laws of New York on August 31, 1945. The name of this company was changed to The National Property Owners Insurance Company on February 13, 1974. On January 1, 1975, National Property Owners Insurance Company was merged with and into NPO and the name of the surviving corporation was immediately changed to The National Property Owners Insurance Company (National Property Owners).

NLT became a wholly-owned subsidiary of American General Corporation (AGC) via an Agreement of Merger, supplemented by an Agreement and Plan of Merger, effective November 4, 1982. Effective January 27, 1984, NLT paid a dividend of the outstanding capital stock of National Property Owners to AGC, and on December 20, 1985, the Tennessee Department approved a petition for the acquisition of National Property Owners by Maryland Casualty Company, a subsidiary of AGC.

On May 15, 1989, Maryland Casualty was acquired by Zurich Insurance Company and National Property Owners was given as a dividend to AGC. National Property Owners changed its name to American General Property Insurance Company (the Company) effective January 1, 1990. On June 30, 1992, the Company merged with Interstate Fire Insurance Company, with the Company being the surviving entity.

The Company's Parent, AGC, completed its acquisition of the Independent Insurance Group, Inc. (IIG) of Jacksonville, Florida, on February 29, 1996. IIG's subsidiaries included four property and casualty insurance companies that write basic needs fire products, primarily in the Southeast. Subject to the terms of an Agreement and Plan of Reorganization, one of IIG's subsidiaries, Independent Fire Insurance Company, was merged with the Company effective February 28, 1999. In accordance with the terms of the Agreement, the Company transferred 150,741 of its issued and outstanding shares to IFIC, a Florida-domiciled insurer, in exchange for IFIC's assets

exclusive of its certificates to write insurance in the various states in which it is licensed. The assets were transferred subject to all liabilities, obligations, claims, security interests and encumbrances of IFIC which were assumed by the Company. The Tennessee Department of Insurance approved the transfer and the Agreement and Plan of Reorganization between IFIC and the Company on May 7, 1999.

On March 30, 1999, pursuant to a Stock Purchase Agreement between AGC Life Insurance Company (AGCL), AGLA and State National Holdings, Inc., dated October 5, 1998, IFIC was sold to State National Holdings, Inc., an unaffiliated Delaware corporation. The sale of IFIC was approved by the Florida Department of Insurance via a Consent Order issued on March 17, 1999. On March 30, 1999 at the closing of the sale of IFIC to State National Holdings, Inc., 150,741 of the issued and outstanding shares of the Company were transferred by IFIC to its sole shareholders, AGCL and AGLA in the following numbers and percentages:

- a. 66,130 shares were transferred to AGCL. AGCL previously held 25,000 shares of the Company. Following the transfer, AGCL owns 91,130 shares of the Company, representing 51.85% of the total issued and outstanding shares of the Company.
- b. 84,611 shares were transferred to AGLA. AGLA did not previously hold any of the Company's shares; AGLA now owns 48.15% of the total and issued outstanding shares of AGPIC.

Although the Company's immediate ownership was affected by this transaction, AGC remained the ultimate controlling person of the Company, AGCL and AGLA.

On August 29, 2001, AGC was acquired by American International Group (AIG), a Delaware corporation. AIG is the leading U.S. based international insurance and financial services organization and the largest underwriter of commercial and industrial insurance in the United States. In connection with the acquisition, AIG issued approximately 290 million shares of its common stock in an exchange for all of the outstanding common stock of AGC based on an exchange ratio of 0.5790 of a share of AIG common stock for each share of AGC common stock.



### **Capitalization**

During the period of examination, the Company's Board of Directors voted to amend the Company's Charter to increase the maximum number of shares of common stock the Company is authorized to issue to one million shares. The amendment became effective September 23, 1998 upon its filing with the Secretary of State, State of Tennessee.

At December 31, 2001, there were 175,741 shares of the Company's common capital stock issued and outstanding. AGC Life Insurance Company held 91,130 shares (51.9%) and American General Life and Accident Insurance Company held 84,611 shares (48.1%).

### **Management and Control**

The Bylaws of the Company state the Annual Meeting of Shareholders may be held at such date and time as shall be designated by the Board of Directors for the purpose of electing a Board of Directors and for the transaction of other such business. Any action required or permitted to be taken at a meeting of the shareholders may be taken without a meeting if consent in writing is signed by all the shareholders entitled to vote with respect to the subject matter thereof. This consent shall set forth the actions so taken and have the same effect as a unanimous vote of shareholders.

The Company's general practice is to hold its annual shareholders meetings in early May. During the period of examination, there were two regular shareholders meetings and three "meetings" by unanimous written consent. One hundred percent (100%) of the outstanding shares were voted by the Company's shareholders, as of record date, at each meeting.

### **Board of Directors**

The Company's Bylaws, as last amended May 5, 1992, state that "the business and property of the Company shall be managed and controlled by the Board of Directors who need not be shareholders or residents of the State of Tennessee" and

that this Board "shall consist of not fewer than three (3) and not more than twenty (20) Directors." A majority of directors constitutes a quorum.

At December 31, 2001, the following persons had been duly elected by the Shareholders and were serving as members of the Board:

<u>Board Member</u>	<u>Business Affiliation</u>
Rodney Owen Martin, Jr., Chairman Houston, TX	President American General Corporation
Donald Wayne Britton Houston, TX	President American General Life Insurance Company
David Anthony Fravel Houston, TX	Senior Vice President, American General Life Insurance Company
David Lawrence Herzog Houston, TX	Executive Vice President American General Life Insurance Company
John Vincent LaGrasse Nashville, TN	Executive Vice President American General Life & Accident Insurance Company
Gary Dalton Reddick Houston, TX	Executive Vice President American General Life Insurance Company

The Company's Bylaws require that the Board hold an annual meeting immediately after the annual meeting of the shareholders. The Bylaws allow any action required or permitted to be taken at a meeting of the Board of Directors to be taken without a meeting if a written consent setting forth the action to be taken is signed by all members of the Board. Directors may also participate in meetings "by means of conference telephone or similar communications equipment," but this method of participation was not used during the period of this examination.

From January 1, 1997, the starting date of the period of this examination, through December 31, 1998, the Board held quarterly meetings in addition to the annual meeting. Beginning April 28, 1999 and continuing through the end of the period of this examination, all of the Board's meetings were conducted by unanimous written consent of all Directors in accordance with the Company's Bylaws.

Any Director may be removed from office by a majority vote of the shareholders then entitled to vote at an election of Directors. Election to remove an officer may be made at any meeting at which a quorum of stockholders is present. The Board may elect additional members as the Directors may determine from time to time. Vacancies "may be filled by the affirmative vote of a majority of the remaining Directors even though less than a quorum." All of the members of the Company's Board with the exception of Director Britton also serve on the Board of its affiliate, American General Life and Accident Insurance Company.

### Officers

The Bylaws provide that "the officers of the Company shall consist of a Chairman of the Board, a President, a Secretary, a Treasurer and such additional officers" as the Board may elect, and as the Chairman of the Board or the President may appoint. The Bylaws prohibit one person from holding the offices of President and Secretary. At December 31, 2001, the following persons had been duly elected to, and were serving in the positions indicated:

Chairman of the Board and CEO	Rodney Owen Martin, Jr.
President	Donald Wayne Britton
Executive Vice President	David Anthony Fravel
Executive Vice President & CFO	David Lawrence Herzog
Executive Vice President & CTO	John Vincent LaGrasse
Executive Vice President	Paul Leo Mistretta
Executive Vice President	Gary Dalton Reddick
Senior Vice President	Wayne Aflin Barnard
Senior Vice President	Robert Michael Beuerlein
Senior Vice President	Craig Wray Clark
Senior Vice President, General Counsel and Secretary	Pauletta Palasota Cohn
Senior Vice President & Treasurer	Gregory Alan Hayes
Senior Vice President	Robert Frank Herbert, Jr.
Senior Vice President & General Counsel	Kyle Lynn Jennings
Senior Vice President	Simon Jonathan Leech
Senior Vice President	Edmund David McClure
Senior Vice President	Mark Russell McGuire
Senior Vice President	Roy Van Washington
Senior Vice President	Steven Elliot Zimmerman
Vice President	Rick Allen Borchert

Vice President & Controller  
Vice President  
Vice President  
Vice President

Charles Kenneth Gibson  
William Larry Mask  
Rembert Reeve Owen, Jr.  
Richard Waldo Scott

### **Committees**

The Bylaws state that the Company may designate "an Executive Committee, consisting of two (2) or more Directors, which shall have all power and authority of the Board not specifically withheld," and "such other committees, each consisting of two (2) or more persons... as may seem desirable for the conduct of the business of the Company." At December 31, 2001, the following persons were duly elected by the Board to serve on the Executive Committee:

Rodney Owen Martin, Chairman  
Donald W. Britton  
David L Herzog

The following persons were duly elected by the Board to serve on the Company's Investment Committee at December 31, 2001:

Richard W. Scott, Chairman  
Albert J. Gutierrez  
Glen Keller  
Gordon S. Massie  
Julia S. Tucker

The investment committee approves each investment. The minutes of the Investment Committee are approved by the Board of Directors and the Committee's decisions are ratified. Copies of the Committee's minutes and a quarterly list of acquisitions and dispositions are attached to the Board minutes. The Company's investment procedures appear to comply with TCA 56-3-408(b)(1).

### **Conflict of Interests**

Prior to the merger with AIG in 2001, American General Corporation published a Policy on Business Conduct which contained a Statement of Policy and Interpretive

Questionnaire, or conflict of interest statement. Directors, officers and key employees of the Company were required to complete the questionnaire annually.

Under AIG, the Company is subject to AIG's Code of Conduct which contains a discussion of Ethical Business Standards. The Company's officers and directors complete the AIG Code of Conduct Re-Certification and Questionnaire on an annual basis. AIG's Corporate Legal Compliance Group (CLCG) has direct responsibility for the distribution, collection and review of the Code of Conduct questionnaires. Human resource managers at each company help to ensure that officers and directors complete the questionnaire on a timely basis. Any potential conflicts of interests are brought to the immediate attention of an attorney in the CLCG. In 2002, the CLCG implemented a process whereby officers and directors can complete the annual Code of Conduct questionnaire online via AIG's intranet site.

The Code of Conduct is imprinted with "American International Group, Inc." and the corporate logo. The questionnaire form is used for all entities within the holding company system. Persons required to complete the questionnaire signed only one form regardless of the number of positions they hold with different companies throughout the AIG holding company system.

Examination procedures included a review of conflict of interest statements completed during the period of examination. Intercompany transactions with other members within the Company's holding company system were also reviewed for purposes of detecting the existence of conflicts of interests. The examiners noted no instances of pecuniary interest as defined in Tenn. Code Ann. § 56-3-103, existing with the Company's officers or directors through the review of these and other corporate documents, records and transactions.

## **Corporate Records**

The Company's current Certificate of Authority was issued January 1, 1990, and is effective until suspended or revoked. The Charter of the Company was approved by the Commissioner of Commerce and Insurance September 23, 1974. During the period of examination there was one amendment to the Company's Charter which increased the capitalization of the Company (discussed above under "Company History"). The Company's Bylaws, as adopted February 11, 1991, and as most recently amended May 5, 1992, were relied upon for this examination. No subsequent amendments were noted. The Company's corporate records are maintained in its Nashville offices.

Minutes of the meetings of the shareholders of the Company from May 1, 1997 through February 27, 2002 were reviewed and found to be in good order. The primary activity on the shareholder's agenda each year was to appoint the Board of Directors.

Minutes of the meetings of the Board of Directors of the Company from February 20, 1997 through November 16, 2002 were reviewed and found to be in good order. All attachments and committee minutes reviewed are kept with the Board minutes.

## **Holding Company System**

The Company and its parent are members of an insurance holding company system as defined by Tenn. Code Ann. § 56-11-201. A consolidated organizational chart is attached to this report as Attachment A. The Company's ultimate parent, American International Group, files a Holding Company Registration Statement annually as required by Tenn. Code Ann. § 56-11-205. Prior to AIG's acquisition of AGC, the Statement was filed annually by AGC. The following is a summary of contracts and agreements that were in place during the period of examination with other members in the Company's holding company system. All relationships and related transactions were verified to have been properly reported in the annual Holding Company Registration Statement submitted to the Tennessee Department of Commerce and Insurance as required by statute.

### **Servicing Agreement**

The Company is party to a Servicing Agreement with all other entities in the American General group which states that,

...each AFFILIATE, when called upon by another AFFILIATE to provide a service which the former is qualified to perform, to provide such requested service to such AFFILIATE ... the AFFILIATE providing such service is reimbursed for costs and expenses which it has incurred in providing such service by the AFFILIATE receiving such service, so that neither AFFILIATE incurs a loss nor realizes a profit at the expense of the other AFFILIATE...

This Agreement is supplemented by a Standard Practice Memorandum from AGC, dated December 19, 1996, which states that direct expenses between entities "must be substantiated by an invoice or other documentation" and that allocated expenses, such as salaries and overhead, are to be "based on an approved allocation methodology," which is reviewed by department managers at least annually. Invoices between entities are to be prepared and mailed monthly and balances are to be cleared quarterly.

The original Servicing Agreement was executed July 31, 1975, and the Company was added by amendment January 1, 1984, as were other entities as they were acquired by AGC. The Agreement was determined to satisfy the requirements of Tenn. Code Ann. § 56-11-206(a)(1) during the previous examination of the Company.

### **Memorandum of Understanding**

The Company is also a party to a Memorandum of Understanding between itself and AGLA whereby AGLA's sales personnel will issue and service insurance policies on behalf of the Company. In return, the Company agrees to "pay AGLA for its services an amount equal to ten percent (10%) of Insurance Revenues [premiums collected less returns]." This Memorandum which was addressed in the previous examination is an "informal interpretation of one aspect of the services that are to be provided under the terms and conditions of the Servicing Agreement" (discussed above). The Servicing Agreement was determined in the previous examination to satisfy the requirements of Tenn. Code Ann. § 56-11-206(a)(1)..

**Intercompany Note (Liquidity Program)**

Effective December 31, 1986, the Company entered into an Intercompany Note with AGC under which the Company may borrow sums from AGC to meet liquidity needs. Interest is based on the Morgan Prime Rate.

Approval of this liquidity program by the Tennessee Department of Commerce and Insurance was granted June 8, 1987, and was determined to be exempt from TCA 56-11-206(a)(3) as long as the outstanding balance owed by the Company does not exceed the lesser of 10% of the Company's admitted assets or 50% of the Company's capital and surplus in excess of the minimum capital and surplus requirement. The Company had no outstanding balances under this note during the examination period.

**Investment Policy**

The Board of Directors adopts an investment policy for the Company annually, usually at its November meeting. The investment policies for 2001 and 2002 were reviewed and appear to be in compliance with the limitations established by Tenn. Code Ann. § 56-3-303. The Company's investment practices, as performed by the investment committees and officers, appear to follow the guidelines as established by the investment policy.

**Investment Pool Agreement**

The Company is party to an Investment Pool Agreement with all other entities in the American General Group. The agreement permits the Insurers and other AG affiliates to invest funds in three short-term pools: a liquidity pool consisting of money market instruments with short maturities, a money market pool consisting of intermediate-term money market instruments; and a securities lending pool consisting of money market instruments with intermediate maturities. The agreement states that American General Investment Management LP (AGIM) will manage the pool and State Street Bank and Trust Company will be the fund custodian. The proposed Investment Pool Agreement was submitted for prior approval to the Department of Commerce and



Insurance on July 9, 1999 in accordance with Tenn. Code Ann. § 56-11-206 (2) (D) and received approval on August 18, 1999.

#### **Investment Management Agreement**

The Company was party to an investment agreement with AGIM that was in effect during the period of examination. The Agreement is part of an original Servicing Agreement with AGC executed on July 31, 1975. AGPIC signed the agreement on September 17, 1984 in its former name The National Property Owners Insurance Company. This agreement was reviewed in the previous examination and was determined to satisfy the requirements of Tenn. Code Ann. § 56-11-206(a) (1).

#### **Investment Advisory Agreement**

The Company's investment manager, AGIM, was replaced by AIG Global Investment Corp (AIGGIC) in an Investment Advisory Agreement executed on January 1, 2002. This agreement was submitted for prior approval to the Department of Commerce and Insurance in accordance with Tenn. Code Ann. § 56-11-206 (2) (D) and received approval on March 22, 2002.

#### **Intercompany Federal Income Tax (FIT) Consolidation Agreements**

The Company was party to three Federal Income Tax (FIT) Consolidated Agreements during the period of examination:

- 1) The Company was party to a Restated and Amended American General Corporation Holding Company System Agreement Concerning the filing of Consolidated Federal Income tax Returns beginning Tax Year 1984 that was executed on May 24, 1989 with an effective date of January 1, 1984. At the time of this agreement, the Company was listed in its former name, The National Property Owners Insurance Company. This FIT agreement covered the filing of a consolidated federal income tax return with the parent company AGC and affiliates through Tax Year 1997. The agreement was reviewed in the previous examination and determined to satisfy the requirements of Tenn. Code Ann. § 56-11-206(a)(1).

- 2) The Company was party to a Restated and Amended American General Corporation Holding Company System Agreement Concerning the filing of Consolidated Federal Income Tax returns beginning Tax Year 1998. This agreement, which was executed on August 18, 1999, covers the filing of a consolidated federal income tax return with the parent company, AGC, and affiliates through August 29, 2001. This FIT agreement was submitted for prior approval to the Department of Commerce and Insurance in accordance with Tenn. Code Ann. § 56-11-206 (2) (D) and received approval on April 20, 1999.
- 3) After the acquisition of AGC by AIG, the Company became a party to an Agreement Concerning the Filing of Consolidated Federal Income Tax Returns beginning Tax Year 2001. This agreement, which was executed on September 11, 2002, covers the filing of a consolidated federal income tax return with American General Property Insurance Company being the "Parent" and American General Property Company of Florida being the "Subsidiary". This agreement covers the filing of consolidated federal income tax returns from August 30, 2001 to the present. This FIT agreement was submitted for prior approval to the Department of Commerce and Insurance in accordance with Tenn. Code Ann. § 56-11-206(2)(D) and received approval on April 4, 2002.

### **Reinsurance Agreements**

The Company is party to reinsurance agreements with some of its affiliates which are described in the Reinsurance section of this examination report.

### **Dividends**

The Company did not pay any dividends to its Parent during the period under examination.

### **Fidelity Bond and Other Insurance**

The Company is a named insured on a Financial Institution Bond carried by its parent company, American General Corporation. The bond has an aggregate and single limit of \$100,000,000 with a deductible of \$5,000,000. This is in excess of the minimum range recommended by the NAIC of \$450,000 to \$500,000.

Other insurance policies were reviewed and the major coverages in effect as of the date of this examination are summarized below. Coverages listed are in the name of the Company's parent, AGC, and the Company is covered as an insured subsidiary.

<u>Type of Coverage</u>	<u>Limits &amp; Deductibles</u>	
Commercial General Liability	\$ 2,000,000	General Aggregate
	\$ 1,000,000	Each Occurrence
	\$ 25,000	Deductible per occurrence
Commercial General Liability	\$ 1,000,000	Combined Limit - BI/PD
Employee Benefits Liability	\$ 1,000,000	Deductible per occurrence
Workers' Compensation	Stat. Limits	
	\$ 1,000,000	Deductible per occurrence
Automobile Liability	\$ 1,000,000	Combined Limit
	\$ 500,000	Deductible per occurrence
Blanket Property, Rental Income & Extra Expense, Including EDP & Valuable Papers	Blanket Limit	Each Occurrence
	\$ 100,000	Deductible
Commercial Crime Policy	\$ 3,000,000	Each Occurrence
Outside Property Managers	\$ 25,000	Deductible per occurrence
Pension Trust (Fiduciary)	\$ 50,000,000	Total Limit
Insurance	\$ 250,000	Deductible per occurrence
Group Travel Accident	\$ 5,500,000	Aggregate Limit
		No Deductible
Directors and Officers Liability	\$ 15,000,000	Per Wrongful Act and Aggregate
Excess Umbrella Coverage	\$ 300,000,000	Excess of primary limits
	\$ 25,000	Deductible - SIR

The insurance companies affording coverage at both the date of examination and current were reviewed to determine if coverage was provided by companies

licensed to operate in the State of Tennessee. As a result of this review, it was determined that all companies except for two were found to be licensed in the State. The two insurance companies in question are X.L. Insurance Company Ltd. and A.C.E. Insurance Company Ltd. Both companies provided excess insurance as of the date of examination, are located in the country of Bermuda, and are not licensed to operate in either Tennessee or Texas (location of AGC). However, subsequent to the date of examination, the Company (with AIG as its ultimate parent) renewed similar coverages with companies licensed to operate in Tennessee.

### **Employee Welfare**

The Company has no employees. All functions are performed by affiliate companies, primarily American General Life and Accident Insurance Company. See discussions of the Servicing Agreement and Memorandum of Understanding under caption "Management and Control."

### **Territory, Plan of Operation and Direct Premiums by State**

The Charter of the Company states its purpose is "to engage in, and do all things necessary to engage in, the business of" disability, property, casualty and surety insurance and reinsurance. In 2001, the Company wrote business in eighteen states in which it is licensed as follows:

<b><u>State</u></b>	<b><u>Direct Premium</u></b>
Alabama	\$ 5,378,792
Arkansas	690,604
Delaware	9,646
Georgia	5,563,332
Illinois	102,131
Indiana	78,755
Kansas	34,059

<u>State</u>	<u>Direct Premium</u>
Kentucky	1,376,198
Louisiana	1,201,668
Maryland	20,956
Mississippi	2,915,736
Missouri	86,138
Ohio	136,109
Oklahoma	72,836
Pennsylvania	278,818
South Carolina	4,300,771
Tennessee	2,197,877
Vest Virginia	<u>71,361</u>
<b>Total</b>	<b><u>\$ 24,515,787</u></b>

In addition to the above, the Company is licensed in the following twenty-six states but wrote no premium in them in 2001:

Arizona	Iowa	New Mexico	Utah
California	Maine	North Carolina	Vermont
Colorado	Massachusetts	North Dakota	Virginia
Connecticut	Michigan	Oregon	Washington
Dist. Of Columbia	Minnesota	Rhode Island	Wisconsin
Florida	Montana	South Dakota	
Idaho	Nebraska	Texas	

The certificates of authority for all states listed above were reviewed without exception. In June 2000, the Company discontinued sales of new business and began non-renewing certain unprofitable business. The Company is currently in runoff and all direct business represents renewals of existing policies.

Since the Company has no employees, its products are sold by agents of its affiliate, American General Life and Accident Insurance Company (AGLA), under a

Memorandum of Understanding as discussed above under the caption "Management and Control." This agreement is exempt from TCA 56-6-401 as it applies to AGLA's "employees or the employees of" an "affiliated" company. Agents sign a Sales Employee Employment Agreement that applies to both the AGLA and the Company. This agreement identifies the specific rules, instructions and expected conduct of agents, staff supervisors, management training associates and district managers in the selling of insurance. (See caption "Market Conduct Activities" for further discussion of the Company's underwriting practices.) A sample of agreements was reviewed for proper execution with no exceptions. The Company's procedures for appointing agents and reporting them to the Tennessee Department during the period of examination were reviewed for a selected sample of agents. Based on the examiners review, it appears that the Company appoints and reports agents in accordance with TCA 56-6-152(a) and 153(a).

### **Growth of Company**

The growth of the Company, as reported by the Company in its annual statements is presented as follows:

<u>Year</u>	<u>Net Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus</u>	<u>Net Written Premium</u>
1997	27,923,789	17,259,263	10,664,526	31,860,143
1998	29,406,649	19,869,675	9,536,974	30,237,506
1999	68,589,754	25,093,979	43,495,775	42,776,544
2000	73,237,899	21,891,021	51,346,878	33,366,612
2001	82,160,285	18,198,046	63,962,239	24,885,072

### **Loss Experience**

The loss experience of the Company, for the period under examination, is presented as follows:

<u>Year</u>	<u>Net Earned Premium</u>	<u>Net Losses Incurred</u>	<u>Loss Ratio</u>	<u>Net LAE Incurred</u>	<u>Losses &amp; LAE Ratio</u>
1997	31,845,734	20,713,913	65.0%	1,490,617	69.7%
1998	30,232,049	24,009,177	79.4%	1,599,566	84.7%
1999	42,077,068	25,019,310	59.5%	1,863,715	63.9%
2000	34,419,271	17,809,085	51.7%	1,101,163	54.9%
2001	26,155,585	11,889,920	45.5%	1,319,508	50.5%

### Statutory Deposits

In compliance with statutory and other requirements, the Company maintained the following deposits with the named jurisdictions at December 31, 2001:

<u>State</u>	<u>Description</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Market Value</u>
AR	U.S. Tr. Notes; 6.625%; due 5/15/07	\$105,000	\$113,414	\$115,336
FL	FL St Bd Ed Mun Bds; 4.6%, due 1/1/08	150,000	148,619	153,428
GA	U.S. Tr. Notes; 8.375%; due 8/15/08	35,000	35,258	37,915
LA	U.S. Tr. Notes; 6.625%; due 5/15/07	70,000	75,609	76,891
NM	Swstrn Bell Co Mtn; 5.73%; due 10/21/02	40,000	40,000	40,904
	U.S. Tr. Notes; 5.75%; due 8/15/03	270,000	270,512	282,782
NC	U.S. Tr. Notes; 6.625%; due 5/15/07	85,000	91,811	93,367
OR	U.S. Tr. Notes; 5.75%; due 8/15/03	410,000	410,778	429,409
SC	U.S. Tr. Bds; 10%; due 5/15/10	20,000	19,731	23,625
	U.S. Tr. Notes; 6.625%; due 5/15/07	100,000	108,013	109,844
	U.S. Tr. Notes; 5.75%; due 8/15/03	130,000	130,247	136,154
TX	U.S. Tr. Notes; 5.75%; due 8/15/03	50,000	50,095	52,367
VA	U.S. Tr. Notes; 5.625%; due 5/15/05	300,000	313,508	314,298
	U.S. Tr. Bds; 10%; due 5/15/10	30,000	29,597	35,438
<b>Total Special Deposits (not all policyholders)</b>		<b>1,795,000</b>	<b>1,837,192</b>	<b>1,901,758</b>

State	Description	Par Value	Statement Value	Market Value
TN	U.S. Tr. Bds; 10%; due 5/15/10	100,000	98,655	118,125
	U.S. Tr. Notes; 6.625%; due 5/15/07	1,590,000	1,717,407	1,746,520
	U.S. Tr. Notes; 6.125%; due 8/15/07	130,000	130,596	139,750
	U.S. Tr. Notes; 5.75%; due 8/15/03	520,000	520,986	544,617
	U.S. Tr. Notes; 6.5%; due 5/15/05	110,000	110,513	118,697
<b>Total Other Deposits (all policyholders)</b>		<b><u>2,450,000</u></b>	<b><u>2,578,157</u></b>	<b><u>2,667,709</u></b>
<b>Total Statutory Deposits</b>		<b><u>\$4,245,000</u></b>	<b><u>\$4,415,349</u></b>	<b><u>\$4,569,467</u></b>

Securities deposited with the State of Tennessee designated as "Other Deposits" are held for the protection of all policyholders of the Company. The \$2,578,157 statement value of the Tennessee statutory deposit at December 31, 2001 far exceeded the \$200,000 required by Tenn. Code Ann. § 56-2-104(a)(2). Securities deposited with all other states designated as "Special Deposits" are held for the protection of Company policyholders residing only in that jurisdiction and/or for other stated purposes. Deposits with all jurisdictions were verified by direct correspondence with the custodians of such deposits.

### **Market Conduct Activities**

#### **Underwriting Practices**

The Company's underwriting emphasis is on fire and allied lines business written on a monthly basis for household contents and dwellings of modest values. Fire insurance represents approximately 80% of premium volume. In June 2000, the Company discontinued sales of new business and began non-renewing certain unprofitable business. As discussed previously under caption "Reinsurance," the Company continues to assume small amounts of fire and allied lines business from other insurers.

#### **Policy Forms**

Because the Company discontinued issuing new business in June 2000, a comprehensive review of policy forms in use was not conducted. Instead, policy forms



previously in use were spot checked for proper filing with various insurance departments with no exceptions noted.

### **Treatment of Policyholders and Claimants**

Claims for the period January 1, 2000 through April 18, 2003 (more than 12,400 records) were reviewed for timeliness of payments which was measured as the number of days from the date the claim was reported to the Company to the date that the claim was paid and/or closed. The Company paid approximately 73% of its claims in 60 days or less for the period reviewed as presented in the table below:

Number of Days to Pay Claim	Dwelling	Personal Property	Living Expense	Other Structures	Other	Total	Percentage
0 – 30	4,044	770	22	168	79	5,083	40.95%
31 – 60	3,209	540	38	141	51	3,979	32.05%
61 – 90	1,250	244	40	66	28	1,628	13.11%
91 – 120	475	105	34	28	13	655	5.28%
121 – 150	239	36	13	10	8	306	2.47%
151 – 180	139	36	6	9	5	195	1.57%
181 – 210	86	20	10	1	3	120	0.97%
211 – 240	53	10	2	2	6	73	0.59%
241 – 270	36	8	6	2	5	57	0.46%
271 – 300	26	8	2	2	2	40	0.32%
301 – 330	23	3	5	4	6	41	0.33%
331 – 360	23	5	4	2	5	39	0.31%
361 +	136	25	10	6	21	198	1.59%

### **Policyholder Complaints**

The Company maintains a complaint register as required by various state Unfair Trade Practices Acts. The register and the accompanying files are maintained for a minimum of five years. A detailed listing of complaints, which identified each by state, complainant and/or insured, policy number, type of complaint, resolution, etc., as reviewed by the examiners is summarized as follows:

<u>Year</u>	<u>Number of Complaints</u>
1997	5
1998	7

1999	8
2000	6
2001	3
2002	3
2003	0 (through July)

The declining number of complaints reflects the Company's discontinued direct writings. A review of the complaint register revealed that the Company appears to be taking appropriate action in a reasonable amount of time. The majority of the Company's complaints is regarding unsatisfactory claim settlements and denied claims.

### **Advertising**

As the Company is no longer writing direct business, it does no advertising.

## **Reinsurance**

The Company had reinsurance coverage in effect at December 31, 2001, as follows:

### **Reinsurance Assumed**

Effective January 1, 1992, the Company entered into a reinsurance agreement with Interstate Mutual Fire Insurance Company (IMFIC) of Chester, Virginia, whereby the Company assumes 90% of IMFIC's fire and allied lines business. This arrangement essentially allows the Company to write business in Virginia even though it is not licensed in that state.

Part of the above agreement stipulated that the Company would underwrite applications obtained by IMFIC and maintain certain administrative records for those policies issued. On June 19, 2000, IMFIC and the Company amended their agreement to acknowledge the decision of the Company "to cease writing applications for policies of insurance against fire and other enumerated perils on dwellings and household contents." While the original agreement remains in full effect with respect to policies in force at June 19, 2000, and the Company continues to assume business from IMFIC,

	<u>Per Occurrence</u>	<u>Aggregate</u>
Retention	\$3,000,000	\$4,450,000
Layer 1	\$7,000,000 xs \$3,000,000	\$7,500,000 xs \$4,450,000
Layer 2	\$15,000,000 xs \$10,000,000	\$2,500,000 xs \$11.950,000
Total	\$22,000,000 xs \$3,000,000	\$10,000,000 xs \$4,450,000

For the 2002 treaty year, the second aggregate layer of coverage was eliminated, and due to the Company's decreasing business and ample surplus, the entire aggregate reinsurance program was eliminated for 2003.

Except as noted above, all of the reinsurance agreements reviewed were found to contain acceptable clauses for insolvency, errors and omissions and arbitration.

### **Accounts & Records**

A review of the Company's accounting system indicates that records appear to conform to generally accepted insurance accounting practices and to accurately reflect the operations of the Company during the period covered by this examination, except as otherwise commented upon in this report. For each of the five years covered by this examination, the Company prepared computer-generated "statutory" trial balances that were reconciled, proved in balance and traced to various exhibits and schedules of the respective annual statements by the examiners. Detail information in the various exhibits and schedules was also traced to worksheets in the Company's December 31, 2001 RBC report to verify accuracy.

The Company's principal accounting records are maintained primarily on an automated computer system, although certain entries each month are completed manually. Accounting records are produced from various source documents including cash receipts, cash disbursements, journal entries and other specific entry documents.

The Company's GAAP and statutory financial statements are reviewed annually as part of the audit performed for the Company's parent and affiliates by an independent CPA firm. Most likely due to its relatively small size in the holding

company system, it does not appear that the Company is audited with the depth afforded its affiliates. However, the independent accountants do issue an annual audit report and management letter separately for the Company. Material weaknesses in the internal control structure of the Company under standards established by the AICPA, if any, would be disclosed in these letters. No such weaknesses were noted in the management letters during the five-year examination period.

The Company utilizes the services of an independent actuarial firm to produce opinions on its loss and loss adjustment expense reserves. For each of the years under review, the opinions were signed by a fellow of the Casualty Actuarial Society and member of the American Academy of Actuaries.

## Financial Statement

There follows a statement of assets, liabilities and a summary of operations as of December 31, 2001 together with a reconciliation of capital and surplus for the period under review, as established by this examination.

### Assets

	<u>Assets</u>	Non-Admitted <u>Assets</u>	Net-Admitted <u>Assets</u>
Bonds	\$ 58,011,320		\$58,011,320
Stocks			
Preferred Stocks	606,219		606,219
Common Stocks	16,942,319		16,942,319
Cash and short-term investments	719,167		719,167
Receivable for Securities	<u>10,691</u>		<u>10,691</u>
Subtotal, Cash and Invested Assets	76,289,716		76,289,716
Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	1,166,812		1,166,812
Reinsurance recoverables on loss and loss adjustment expense payments	1,855		1,855
Federal and foreign income tax recoverable and interest thereon	3,402,000	2,386,000	1,016,000
Guaranty Funds Receivable or on deposit	175,020		175,020
Interest, dividends and real estate income due and accrued	1,051,851		1,051,851
Receivable from parent, subsidiaries and affiliates	214,031		214,031
Other Assets	<u>12,686</u>	<u>12,686</u>	<u>0</u>
 TOTAL ASSETS	 <u>\$ 82,313,971</u>	 <u>\$ 2,398,686</u>	 <u>\$ 79,915,285</u>

### Liabilities, Surplus and Other Funds

Losses		\$14,404,843
Loss adjustment expenses		467,626
Commissions payable, contingent commissions and other similar charges		32,310
Other expenses		30,167
Taxes, Licenses and Fees		493,974
Federal & Foreign Income Taxes		0
Unearned premiums		1,526,254
Ceded reinsurance premiums payable		(494,721)
Funds held by Company Under Reinsurance Treaties		6,508
Amounts withheld or retained by company for account of others		239,884
Remittances and Items Not Allocated		238,048
Provisions for Reinsurance		1,608
Drafts Outstanding		356,155
Payable to Parent, Subsidiaries and Affiliates		225,716
Aggregate Write-Ins for Liabilities		<u>669,674</u>
Total Liabilities		18,198,046
Common capital stock	\$17,574,100	
Gross Paid In and Contributed Surplus	32,527,435	
Unassigned Funds (Surplus)	<u>11,615,704</u>	
Surplus as Regards Policyholders		<u>61,717,239</u>
Totals		<u>\$79,915,285</u>

## Underwriting & Investment Exhibit

### Statement of Income

Premiums earned	\$ 26,155,585
Losses incurred	(11,889,920)
Loss expenses incurred	(1,319,508)
Other underwriting expenses incurred	<u>(6,788,463)</u>
Total underwriting deductions	(19,997,891)
Net Underwriting Gain or (Loss)	6,157,694
Net investment income earned	3,233,675
Net realized capital gains (losses)	<u>539,895</u>
Net Investment Gain	3,773,570
Aggregate Write-In for Miscellaneous Income	<u>4,482</u>
Net Income Before Federal and Foreign Income Taxes	9,935,746
Federal and foreign income taxes incurred	<u>(3,143,389)</u>
Net Income	<u>\$ 6,792,357</u>

Capital and Surplus Account

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
Total capital and surplus, December 31, previous year	\$10,561,020	\$10,664,526	\$9,536,974	\$43,495,774	\$51,346,878
Net income					
Net unrealized capital gains	1,129,606	(3,463,569)	3,699,201	5,756,221	6,792,357
(losses)	2,750	29,862	9,860,463	1,523,121	2,747,094
Change in net deferred income tax					(447,685)
Change in non-admitted assets	(1,859,436)	1,811,292	(2,329,514)	310,347	1,082,057
Change in provision for reinsurance	188,758	(309,132)	288,995	15,816	2,713
Cumulative effect of change in accounting principles					193,825
Change in paid in capital			15,074,100		
Change in paid in surplus			8,302,435		
Dividends to stockholders	1,345,828	857,000	(1,180,000)	245,599	
Extraordinary taxes for prior years					
PY reserve strengthening on reinsurance assumed	(704,000)	(53,005)	243,120		
Net change for the year	<u>103,506</u>	<u>(1,127,552)</u>	<u>33,958,800</u>	<u>7,851,104</u>	<u>10,370,361</u>
Total capital and surplus, December 31, current year	<u>\$10,664,526</u>	<u>\$9,536,974</u>	<u>\$43,495,774</u>	<u>\$51,346,878</u>	<u>\$61,717,239</u>



## **Analysis of Changes in Financial Statement**

### **Federal & Foreign Income Tax Recoverable**

**\$1,016,000**

The above amount per examination is \$2,245,000 less than reported by the Company in its December 31, 2001 annual statement. The Company reports its FIT on a consolidated basis as discussed earlier in this report under "Holding Company System – Intercompany Federal Income Tax Consolidation Agreements." Included in the Company's December 31, 2001 FIT Recoverable was a \$2,245,000 FIT receivable carry-forward balance from affiliates from prior years. SSAP #10 requires that amounts owed as a result of a consolidated filing that are not settled within 90 days of the filing or within 90 days of the receipt of a refund must be treated as a loan or advance and non-admitted. Therefore, the Company's receivable is being non-admitted for purposes of this examination.

The Company accrued FIT expenses based on an estimate for taxes payable of \$2,454,010. Actual settlement for 2001 taxes subsequent to year end indicates the Company had an additional \$170,000 in FIT payable to the IRS. The true up of this expense was appropriately accounted for in 2002 in accordance with SSAP #10 - Federal Income Taxes and SSAP #3 - Accounting Changes.

**Summary Schedule for "Analysis of Changes in Financial Statement"**

<u>Item</u>	<u>Change in Surplus</u>	
	<u>Increase</u>	<u>Decrease</u>
Federal & Foreign Income Tax Recoverable		<u>\$2,245,000</u>
Decrease per examination		<u><u>\$2,245,000</u></u>

## **Recommendations**

### **Statutory Deposits**

Tennessee Statutes provide that if a Company maintains a special deposit in another state that is held for the benefit of only that state's policyholders, and the deposit exceeds the Company's liabilities for that state's policyholders, the excess shall be reported as a non-admitted asset. Tenn. Code Ann. § 56-1-405 allows the Commissioner to credit any deposit of funds of the Company that are deposited for the purpose of meeting the requirements for doing business in another state or commonwealth but the Commissioner must approve such special deposits.

The Company maintained special statutory deposits at December 31, 2001 aggregating \$1,837,192 with the states of Arkansas, Florida, Georgia, Louisiana, New Mexico, North Carolina Oregon, South Carolina, Texas and Virginia that were designated as only for policyholders of those states. No determination was made by the Company as to the amount the deposits exceeded the Company's liabilities for the policyholders of these respective states. Furthermore, the Company neither requested nor received Departmental approval to admit any excess deposits.

The examiners determined that any resulting adjustment would be below the threshold of materiality, therefore the balance reported by the Company in its December 31, 2001 annual statement has been accepted as fairly stated for purposes of this examination. However, it is recommended that the Company either request Departmental approval to admit excess statutory deposits, or determine the amount the deposits exceed the liabilities set aside for policyholders of the respective states and non-admit any excess amounts. This recommendation was also noted in the Company's previous report on examination.

### **Bonds & Stocks**

In accordance with NAIC examination procedures, the examiners requested trade tickets and brokers advices as support for a sample of the Company's purchases and sales of securities. Despite repeated requests, the information could not be provided. Alternative examination procedures that tested these transactions by using

information obtained from other sources were performed without exception by the examiners in order to satisfy the examination objectives for the related financial statement items.

The Company attempted to provide the requested information to the examiners but records management shortcomings prevented them from doing so. Based upon correspondence with Company personnel, this information was being kept at the offices of the Company's parent in Houston, TX in such a disorganized manner that it could not be located. Another contributing factor was the transfer of many the investment records of the parent Company to New York as a result of their acquisition by AIG. It is recommended that the Company implement improvements in its investment records management and retention procedures to ensure that these original records can be provided to the examiners in accordance with Tenn. Code Ann. § 56-1-411(b)(1).

#### **Intercompany Federal Income Tax Consolidation**

Included in this examination report is an adjustment to reduce FIT recoverable due primarily to untimely settlement of income taxes between affiliates. The consolidated income tax agreements between the Company, its parent and other affiliates require payments be made for any related intercompany balances when due. The Company is not complying with this term of the agreement, nor is it complying with SSAP #10 by reporting the related receivables as admitted assets. It is recommended that the Company change its method of accounting for FIT recoverable in order to comply with Tenn. Code Ann. § 56-1-501(g) which provides that financial statements shall be prepared in accordance with the National Association of Insurance Commissioners Accounting Practices and Procedures Manual.

## **Comments**

### **Risk Based Capital**

The RBC levels and comparisons to adjusted capital as reported by the Company in its December 31, 2001 annual statement are as follows:

Total Adjusted Capital Per Exam		\$60,930,214
Company Action Level	\$8,180,070	745%
Regulatory Action Level	6,135,053	993%
Authorized Control Level	4,090,035	1,490%
Mandatory Control Level	2,863,025	2,128%

Financial statement adjustments made as a result of this examination are deemed immaterial with respect to the Company's December 31, 2001 RBC levels; therefore no recalculations of the above Action and Control levels were performed as a result of the exam adjustments.

### **Bonds & Stocks**

The Company's Custodian Agreement with State Street Bank and Trust in effect as of the date of examination did not meet the requirements set forth by Tenn. Code Ann. § 56-3-112(b) and Regulation 0780-1-46-.04. The Company, State Street Bank and certain representatives of the Tennessee Department of Commerce and Insurance worked to resolve the problem prior to the completion of the examination and created a newly amended agreement dated June 3, 2003 that met the standards set forth by Statutes.

### **Conflict of Interest Statements**

Examination procedures included a review of conflict of interest statements completed by the Company's directors and officers as listed on the jurat pages in the 1997 through 2002 Annual Statements. The Company was unable to provide completed statements for 1997 and 1998 for 47 Company officials due to the fact the questionnaires had been archived in storage and were unable to be located. For years

1999-2002, the Company was able to locate questionnaires for all but 7 of the Company's officials. It is recommended that the Company implement stricter and more comprehensive procedures that ensure completed questionnaires are received for all Company officials and that they are readily available for review by representatives of the Tennessee Department of Commerce and Insurance.

### **Losses & LAE**

The Tennessee Department of Commerce and Insurance contracted with an independent actuarial firm to assist with this examination. It is their opinion that booked reserves are within a range of reasonable reserve estimates, therefore no adjustments to net or gross loss and LAE reserves have been made for examination purposes. Recommendations as a result of their examination of the Company's reserves are as follows:

- It is recommended that the Company review the reasonableness of ULAE reserves by line of business in conjunction with the completion of future annual statements. The Company used independent methodologies to estimate the net ULAE reserve for fire and allied lines business and for discontinued lines of business. It was noted that booked ULAE reserves for the minor lines of run-off business are disproportionately large compared to the booked ULAE reserves for the fire and allied lines business. The Company also booked a reinsurance ceded ULAE reserve for the homeowners line of business when there is not a corresponding ceded loss reserve.
- The reserve opinions and supporting reserve studies prepared by the Company's actuaries were reviewed for 2001 and 2002. The 2001 opinion was prepared by Tillinghast-Towers Perrin and contained generally standard language and did not indicate any unusual issues. In 2002, the Company changed actuaries and the opinion was prepared by an officer of the Company's parent, AIG. The 2002 opinion indicates the Company's practice is to record 100% of the reserves for underwriting pools and associations without an accrual for any reporting lag. The 2001 reserve study indicated that historically the Company has reported these reserves on a cash basis. Since the Company has not changed its accounting practices regarding pools and associations, the language in the 2002 reserve opinion does not appear to be accurate.
- Some errors were noted in the Company's procedure for reporting of loss and LAE data in their 2001 annual statement. The Case Basis Losses Unpaid reserve for a single Workers' Compensation claim is reported as an IBNR reserve. The ceded AO reserves shown in Schedule P – Part 1, Column 22 are

not shown in Schedule F – Part 3, Column 12. However, it was noted that this reporting discrepancy was corrected in the 2002 annual statement.

## **Conclusion**

The customary insurance examination practices and procedures, as promulgated by the National Association of Insurance Commissioners, have been followed in connection with the verification and valuation of assets and the determination of liabilities of American General Property Insurance Company.

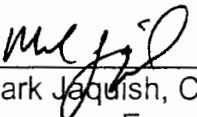
In such manners, it was determined that, as of December 31, 2001, the Company had admitted assets of \$79,915,285 and liabilities, exclusive of capital and surplus, of \$18,198,046. Thus, there existed for the additional protection of the policyholders, the amount of \$61,717,239 in the form of common capital stock, gross paid-in and contributed surplus and unassigned funds (surplus).

The courteous cooperation of the officers and employees of the Company extended during the course of the examination is hereby acknowledged.


In addition to the undersigned, Mr. R. Glenn Taylor, ACAS, MAAA, of Taylor-Walker and Associates, Inc. and Ms. Dinah Reddix, Examiner, Tennessee Department of Commerce and Insurance participated in the work of this examination.

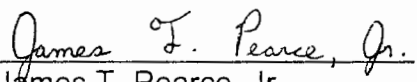
Respectfully submitted,

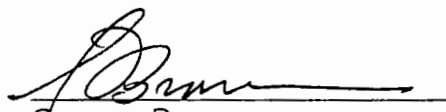


  
Mark Jaquish, CFE, CPA  
Insurance Examiner-in-Charge  
Tennessee Department of Commerce and Insurance

  
Juli-Kay Baumann, ARM, ARe, AIE, CFE, CPCU  
Representing the Tennessee Department of Commerce and Insurance

  
W. Greg Taylor, CFE  
Representing the State of Delaware  
Northeastern Zone

  
James T. Pearce, Jr.  
Examiner III, Tennessee Department of Commerce and Insurance

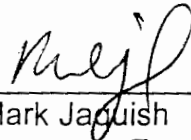
  
Gregory Bronson  
Examiner II, Tennessee Department of Commerce and Insurance

  
R. Scott Creel  
Examiner II, Tennessee Department of Commerce and Insurance

  
Michael Lamb  
Examiner II, Tennessee Department of Commerce and Insurance

### Examination Affidavit

The undersigned deposes and says that he has duly executed the attached examination report of American General Property Insurance Company dated January 8, 2004 and made as of December 31, 2001, on behalf of the Tennessee Department of Commerce and Insurance. Deponent further says he is familiar with such instrument and the contents thereof, and that the facts therein set forth are true to the best of his knowledge, information and belief.



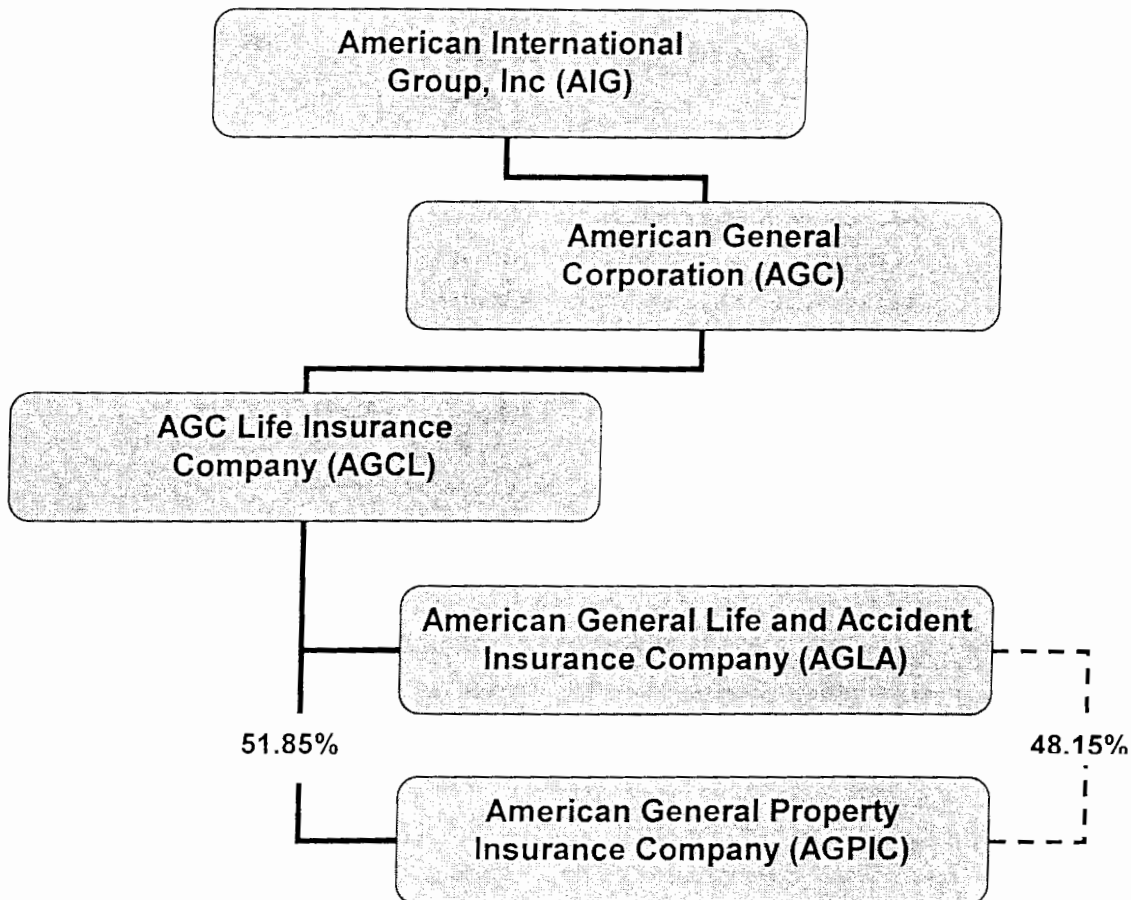
Mark Jaguish  
Insurance Examiner  
State of Tennessee

County Davidson  
State Tennessee

Subscribed and sworn to before me  
this 30th day of  
August, 2004.

Helen M. Lantry  
(Notary)

## Organizational Chart



Organizational Chart showing all affiliated companies of AIG Holding Company is filed as an attachment to Holding Company Registration Statements which are filed annually with respective states' insurance

ATTACHMENT A

ROBINS H. LEDYARD  
TEL: (615) 742-6259  
FAX: (615) 742-2759  
[Rledyard@bassberry.com](mailto:Rledyard@bassberry.com)

## BASS, BERRY & SIMS PLC

A PROFESSIONAL LIMITED LIABILITY COMPANY  
ATTORNEYS AT LAW

AMSOUTH CENTER  
315 DEADERICK STREET, SUITE 2700  
NASHVILLE, TN 37238-3001  
(615) 742-6200

[www.bassberry.com](http://www.bassberry.com)

OTHER OFFICES:

NASHVILLE MUSIC ROW  
KNOXVILLE  
MEMPHIS

September 2, 2004

### BY MESSENGER

Honorable Don Spann, CFE  
Insurance Examination Director  
Department of Commerce and Insurance  
500 James Robertson Parkway  
Nashville, Tennessee 37243

Re: Financial Condition Examination of American General  
Life and Accident Insurance Company and  
American General Property Insurance Company  
Made as of December 31, 2001

Dear Mr. Spann:

Thank you very much for copying us on your letters of August 30, 2004 and the enclosed Examination Reports on American General Life and Accident Insurance Company and American General Property Insurance Company. We represent those companies and have been asked to respond to the Report.

Kathy Fussell's description of our agreement (to make written submission or rebuttal with respect to matters contained in the Report within a seven (7) day period) is absolutely correct. This letter is intended to constitute such written submission or rebuttal.

#### Director and Officer Compensation (p. 46 -- AGLAIC).

At the outset, it is important to note that the entirety of Tenn. Code Ann. Section 56-3-105 applies only to payments made by domestic stock or mutual life insurance companies, or to domestic fraternal benefit societies. It does not apply to payments that a domestic insurance company's affiliates may make. We think that the Division has uniformly approached Tenn. Code Ann. Section 56-3-105 on the basis of strict interpretation, which limits its application to payments made by such companies. Several other points should be made: First, the excerpt describing subsection (a)(1) effectively has two categories. The first involves directors or employees who earned less than the amount set forth in the appropriate schedule of the Annual Statement filed with the commissioner pursuant to Section 56-1-501. . . ." and the company may compensate such directors and officers without first securing board approval. The second category involves directors and officers who make more than such amount and they may be so

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compensated upon authorization "by a vote of the board of directors of such company or society . . . ." Second, subsection (a)(2) provides that any officer or director who is paid a salary of more than \$100 per month may not receive any other compensation or emolument, and we believe this would be true for officers and directors in both of the categories described above. Third, subsection (b) provides a number of exceptions, none of which appears to be germane in the circumstance.

Here, the actions described in the draft Examination Report (i.e., payment of bonus and other compensation to certain officers of the company) were done by a company other than American General Life and Accident Insurance Company. We believe that Section 56-3-105 has no application to the compensation arrangements in question. We suggest that if any provision in Insurance Law has such application, it would probably be Tenn. Code Ann. Section 56-11-206(a)(2)(D).

We understand that American General Life & Accident Insurance Company became a party to a document captioned "Service and Expense Agreement" between American General Life and Accident Insurance Company and various AIG affiliates. We understand that the Service and Expense Agreement is a cost allocations arrangement based on generally accepted accounting principles, and that it continues to fulfill the same purpose in substantially the same way as an earlier agreement between and among members of the American General Corporation family of companies. We understand, but have not confirmed with certainty, that the various Service and Expense Agreements have been filed with the Tennessee Department of Commerce and Insurance and other regulatory authorities as and when required by law. Generally, we believe that the time when Tennessee law requires such filing would be when Forms B are filed. We also believe that prior approval under Tenn. Code Ann. Section 56-11-206(a)(2) is not required of the cost-sharing portion of the Service and Expense Agreement.

Accordingly, the Company's actions on this point fully complied with Tenn. Code Ann. Section 56-3-105 and all relevant Tennessee laws.

#### **Subsequent Events (p. 46 -- AGLAIC).**

The American General Corporation Pension Plan Trust (the "Trust") was not an "affiliate" of American General Life and Accident Insurance Company (the "Company") at any time prior to the Trust's merger into the AIG Pension Plan on February 1, 2002. The merger of the two plans involved no action of any type by the Company in the nature of voting on or consenting to the merger of the plans, nor was any such vote or consent required. The term "affiliate" is defined in Tenn. Code Ann. Section 56-11-201(b)(1), and the term "control" (an essential part of the term "affiliate") is defined in Tenn. Code Ann. Section 56-11-201(b)(3). This may be counterintuitive, but is correct statutory analysis. Accordingly, the merger of the two plans is not subject to Tenn. Code Ann. Section 56-11-206.

In addition, in or as a result of the merger of the two plans, the Company took no action of any type involving any transfer of assets. The term "distribution" is defined in Tenn. Code Ann. Section 48-11-201(8) as "a direct or indirect transfer of money or other property or

September 2, 2004

incurrence of indebtedness by a corporation to or for the benefit of its shareholders in respect of any of its shares. A distribution may be in the form of a declaration or payment of a dividend; a purchase, redemption or other acquisition of shares; a distribution of indebtedness (which includes the incurrence of indebtedness for the benefit of the shareholders); . . ." Here, the company took no action whatsoever other than to account for merger consequences in the required way in required statutory financial statements, and there is no distribution or dividend for any statute to regulate.

Finally, the merger of the two plans is not a transaction to which Section 56-11-206 does or should apply for at least two other several reasons:

First, the plan mergers did not benefit the company's shareholders;

Second, the company's surplus was entirely unaffected by the merger of the two plans (and surplus adequacy is so important in this regard that the General Assembly devoted the entirety of Tenn. Code Ann. Section 56-11-206(d) to surplus adequacy criteria).

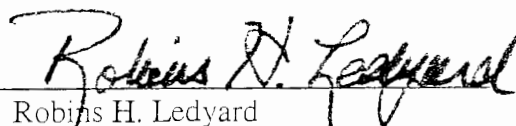
Accordingly, the Company's actions on this point fully complied with all relevant Tennessee laws.

\* \* \*

If you or others at the Department have questions or observations, I will very much appreciate your call. You should also feel free to call Sharon Roberson or Chris Aiken.

Very truly yours,

BASS, BERRY & SIMS PLC

By   
Robins H. Ledyard

RHL:rg

Copy to: Mr. Chris Aiken (By Facsimile (749-1808))  
Sharon K. Roberson, Esq. (By Facsimile (749-1808))  
✓ Hon. Eric Stansell, Esq. (By Messenger)



September 8, 2004

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Dept. Of Commerce & Insurance  
Company Examinations

Mr. Don Spann, CFE  
Insurance Examination Director  
Tennessee Department of Commerce & Insurance  
Davy Crockett Tower, Fifth Floor  
500 James Robertson Parkway  
Nashville, TN 37243-0565

Re: American General Property Insurance Company (The Company or AGPIC)  
Company Response to Financial Statement Changes and Recommendations in the Final  
Examination Report For the Period Ending December 31, 2001

Dear Mr. Spann:

We have received your August 30, 2004 letter addressed to Mr. James A. Mallon and the accompanying copy of the final examination report for AGPIC covering the period ending December 31, 2001. The purpose of this letter is to provide Management's responses to the Financial Statement Changes, Recommendations, and Comments included in the report. We have addressed each issue using the identifying captions contained in the examination report.

**Analysis of Changes in Financial Statement**

**Federal & Foreign Income Tax Recoverable (Page 31)**

**Examination Comment** – *The Company reports its FIT on a consolidated basis as discussed earlier in this report under "Holding Company System –Intercompany Federal Income Tax Consolidation Agreements." Included in the Company's December 31, 2001 FIT Recoverable was a \$2,245,000 FIT receivable carry-forward balance from affiliates from prior years. SSAP #10 requires that amounts owed as a result of a consolidated filing that are not settled within 90 days of the filing or within 90 days of the receipt of a refund must be treated as a loan or advance and non-admitted. Therefore, the Company's receivable is being non-admitted for purposes of this examination.*

*The Company accrued FIT expenses based on an estimate for taxes payable of \$2,454,010. Actual settlement for 2001 taxes subsequent to year end indicates the Company had an additional \$170,000 in FIT payable to the IRS. The true up of this expense was appropriately accounted for*

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Member of American International Group, Inc.  
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*in 2002 in accordance with SSAP #10 – Federal Income Taxes and SSAP #3 – Accounting Changes.”*

**Management Response** – Management agrees that the Company had a FIT receivable carry-forward balance from affiliates from prior years, however, the amount of this carry-forward balance was \$2,058,685. The difference of \$186,315 represents a FIT receivable for the year ending December 31, 2001 and should not be non-admitted. The delay in settling the \$2,058,685 carry-forward receivable balance from affiliates was an oversight. While this balance has been settled and is no longer an issue, Management agrees with the proposed adjustment to non-admit this receivable (\$2,058,685) on the Company’s December 31, 2001 balance sheet. In the future, Management intends to settle all current income tax receivables within 90 days of the filing of the consolidated income tax return. In the event that a settlement does not occur according to these terms, Management will treat the relevant receivable as a loan and non-admit the balance, pursuant to Statement of Statutory Accounting Principles (SSAP) No. 25 - “Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties”, as described in SSAP No. 10 -“Income Taxes”. Management asserts that the FIT receivable balance (\$186,315) for the current year (2001) should not be non-admitted and believes that the inclusion of this amount was an unintentional oversight by the Department.

## **Recommendations**

### **Statutory Deposits (Page 33)**

**Examination Comment** – *Tennessee Statutes provide that if a Company maintains a special deposit in another state that is held for the benefit of only that state’s policyholders, and the deposit exceeds the Company’s liabilities for that state’s policyholders, the excess shall be reported as a non-admitted asset. Tenn. Code Ann. § 56-1-405 allows the Commissioner to credit any deposit of funds of the Company that are deposited for the purpose of meeting the requirements for doing business in another state or commonwealth but the Commissioner must approve such special deposits.*

*The Company maintained special statutory deposits at December 31, 2001 aggregating \$1,837,192 with the states of Arkansas, Florida, Georgia, Louisiana, New Mexico, North Carolina, Oregon, South Carolina, Texas and Virginia that were designated as only for policyholders of those states. No determination was made by the Company as to the amount the*



*deposits exceeded the Company's liabilities for the policyholders of these respective states. Furthermore, the Company neither requested nor received Departmental approval to admit any excess deposits.*

*The examiners determined that any resulting adjustment would be below the threshold of materiality, therefore the balance reported by the Company in its December 31, 2001 annual statement has been accepted as fairly stated for purposes of this examination. However, it is recommended that the Company either request Departmental approval to admit excess statutory deposits, or determine the amount the deposits exceed the liabilities set aside for policyholders of the respective states and non-admit any excess amounts. This recommendation was also noted in the Company's previous report on examination.*

**Management Response** – In a closing conference on August 17, 2004, between Management and Department personnel, the Company submitted a letter dated August 16, 2004 to Mr. Larry Knight requesting approval to admit the excess portion of its statutory deposits.

#### **Bonds & Stocks (Page 33)**

**Examination Comment** – *In accordance with NAIC examination procedures, the examiners requested trade tickets and brokers advices as support for a sample of the Company's purchases and sales of securities. Despite repeated requests, the information could not be provided. Alternative examination procedures that tested these transactions by using information obtained from other sources were performed without exception by the examiners in order to satisfy the examination objectives for the related financial statement items.*

*The Company attempted to provide the requested information to the examiners but records management shortcomings prevented them from doing so. Based upon correspondence with Company personnel, this information was being kept at the offices of the Company's parent in Houston, TX in such a disorganized manner that it could not be located. Another contributing factor was the transfer of many the investment records of the parent Company to New York as a result of their acquisition by AIG. It is recommended that the Company implement changes in its investment records management and retention procedures to ensure that these original records can be provided to the examiners in accordance with Tennessee Code Ann. §56-1-411(b)(1).*

**Management Response** – Unfortunately, there were some transitional matters that occurred with regards to the filing of investment records subsequent to AIG's acquisition of American General. In the future, Investment Operations Management will ensure that proper filing procedures are employed that will allow for a more efficient retrieval of requested investment documents.

**Intercompany Federal Income Tax Consolidation (Page 34)**

**Examination Comment** – *Included in this examination report is an adjustment to reduce FIT recoverable due primarily to untimely settlement of income taxes between affiliates. The consolidated income tax agreements between the Company, its parent and other affiliates require payments be made for any related intercompany balances when due. The Company is not complying with this term of the agreement, nor is it complying with SSAP #10 by reporting the related receivables as admitted assets. It is recommended that the Company change its method of accounting for FIT recoverable in order to comply with Tenn. Code Ann §56-1-501(g) which provides that financial statements shall be prepared in accordance with the National Association of Insurance Commissioners Accounting Practices and Procedures Manual.*

**Management Response** – This examination comment was previously addressed in the **Analysis of Changes in Financial Statement** (Federal & Foreign Income Tax Recoverable) section of this letter. Management intends to comply with accounting guidance contained in SSAP No. 10.

**Comments**

**Risk Based Capital**

**Examination Comment** The RBC levels and comparisons to adjusted capital as reported by the Company in its December 31, 2001 annual statement are as follows:

Total Adjusted Capital Per Exam		\$ 60,930,214
Company Action Level	\$ 8,180,070	745%
Regulatory Action Level	6,135,035	993%
Authorized Control Level	4,090,035	1,490%
Mandatory Control Level	2,863,025	2,128%

Financial statement adjustments made as a result of this examination are deemed immaterial with respect to the Company's December 31, 2001 RBC levels; therefore no recalculations of the above Action and Control levels were performed as a result of the exam adjustments.

**Management's Response** Management believes that the Total Adjusted Capital Per Exam amount should be updated to reflect the value of \$61,903,554. Further, Management believes that the corresponding RBC ratios should also be updated accordingly, to reflect the adjusted capital value cited above.

#### **Conflict of Interest Statements (Page 35)**

**Examination Comment** – *Examination procedures included a review of conflict of interest statements completed by the Company's directors and officers as listed on the jurat pages in the 1997 through 2002 Annual Statements. The Company was unable to provide completed statements for 1997 and 1998 for 47 Company officials due to the fact the questionnaires had been archived in storage and were unable to be located. For years 1999-2002, the Company was able to locate questionnaires for all but 7 of the Company's officials. It is recommended that the Company implement stricter and more comprehensive procedures that ensure completed questionnaires are received for all Company officials and that they are readily available for review by representatives of the Tennessee Department of Commerce and Insurance.*

**Management Response** - As part of our corporate governance practices, the Company has developed a procedure for confirmation that conflict of interest statements are received from all individuals that are required to submit them. We are implementing this process that will include obtaining assurances of the integrity of our conflict of interest records. The Assistant Corporate Secretary will maintain a copy of these records in Nashville as an assurance that the information will be readily available for review by representatives of the Tennessee Department of Commerce and Insurance. As an alternative, the company may store these documents using electronic media.

#### **Losses & LAE (Page 36)**

**Examination Comment** – *The Tennessee Department of Commerce and Insurance contracted with an independent actuarial firm to assist with this examination. It is their opinion that booked*

reserves are within a range of reasonable reserve estimates, therefore no adjustments to net or gross loss and LAE reserves have been made for examination purposes. Recommendations as a result of their examination of the Company's reserves are as follows:

- *It is recommended that the Company review the reasonableness of ULAE reserves by line of business in conjunction with the completion of future annual statements. The Company used independent methodologies to estimate the net ULAE reserve for fire and allied lines business and for discontinued lines of business. It was noted that booked ULAE reserves for the minor lines of run-off business are disproportionately large compared to the booked ULAE reserves for the fire and allied lines business. The Company also booked a reinsurance ceded ULAE reserve for the homeowners line of business when there is not a corresponding ceded loss reserve.*
- *The reserve opinions and supporting reserve studies prepared by the Company's actuaries were reviewed for 2001 and 2002. The 2001 opinion was prepared by Tillinghast-Towers Perrin and contained generally standard language and did not indicate any unusual issues. In 2002, the Company changed actuaries and the opinion was prepared by an officer of the Company's parent, AIG. The 2002 opinion indicates the Company's practice is to record 100% of the reserves for underwriting pools and associations without an accrual for any reporting lag. The 2001 reserve study indicated that historically the Company has reported these reserves on a cash basis. Since the Company has not changed its accounting practices regarding pools and associations, the language in the 2002 reserve opinion does not appear to be accurate.*
- *Some errors were noted in the Company's procedure for reporting of loss and LAE data in their 2001 annual statement. The Case Basis Losses Unpaid reserve for a single Workers' Compensation claim is reported as an IBNR reserve. The ceded AO reserves shown in Schedule P – Part 1, Column 22 are not shown in Schedule F – Part 3, Column 12. However, it was noted that this reporting discrepancy was corrected in the 2002 annual statement.*

**Management Response** – Management agrees that the Unallocated Loss Adjustment Expense (ULAE) reserve for the runoff classes appears high, and that is the main reason the overall ULAE reserve indicates a redundancy. The ULAE reserve is usually set based on a paid to paid formula like the one that Management employs. However, this formula does not work when there is only a couple of open claims. For the runoff line, Management intends to obtain an appropriate estimate from the claims department on how much future ULAE expense they expect to incur on these remaining claims. The Company is no longer carrying a ceded ULAE reserve on the homeowners' line of business.

Management concurs with the exam comment that the following statement included in the 2002 Actuarial Opinion was incorrect: "The Company's practice is to record 100% of the reserves for these pools and associations without an accrual for any reporting lag". The opining actuary believed that Management recorded the Company's share of reserves from involuntary pools and

associations. However, as a practical matter, Management has historically only recorded any cash settlements with involuntary pools, but has not recorded its share of any loss reserves due to immateriality. The Company's opining actuary has recommended that Management prospectively record its respective share of any reported case reserves reported by pools and associations, assuming that the relevant amounts are material.

The Case Basis Losses Unpaid reserve for a single Workers' Compensation claim was correctly reported as a case reserve rather than an IBNR reserve in the Company's 2003 Annual Statement.

Management appreciates the opportunity to respond to the comments included in the Department's examination report. Please let us know if you have any questions or otherwise require clarification of any Management Responses.

Sincerely,

A handwritten signature in black ink, appearing to read "Chris N. Aiken".

Chris N. Aiken

Director— Financial Reporting